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PLANNING AND PROFITABILITY

Attending management of an accounting practice conferences is a great way to share information and ideas with practitioners from around the country. Participants can ask questions and find out how others solve problems and run their practices. The following questions were asked at various AICPA MAP conferences. Our editorial advisers respond.

Is there a special way to plan for growth—to double revenue in five years, for example?

Richard A. Berenson, a New York City, practitioner, says that a doubling of revenue in a five-year time frame would take a major marketing campaign. Prior to any new-client efforts though, he says, the first step should be to strive to increase revenue from present clients. In addition, all members of the firm would need to be made aware of the growth goals because such a marketing program would require everyone's cooperation. Another essential ingredient, according to Mr. Berenson, would be a monitoring capability to enable the managing partner to review results on a periodic basis.

Predicting such revenue growth is difficult. Abram J. Serotta, who practices in Augusta, Georgia, says that the planning process would need to include a staff plan so that you can service the increased revenue. He asks, "How many CPA firms hire additional staff in excess of their needs before tax season?" If a firm is to grow during tax season (the most likely time that clients switch), says Mr. Serotta, the firm must have staff. Mr. Serotta thinks that once you have a staff growth plan in place, you are then in a position to discuss marketing.

One idea Mr. Serotta suggests might be to assign a quota each month to obtaining five new corporate clients generating, say, between five and ten thousand dollars each. The quotas and goals will help in the efforts to double revenue. Mr. Serotta says this should be in addition to activities aimed at increasing revenue from present clients.

Robert L. Israeloff, a Valley Stream, New York, practitioner, says that when planning growth, it is important to plan for increased profits, as opposed to merely planning for doubling revenue in a certain time frame. He says it may be nice to budget the increased revenue in an orderly manner, but it may not be practical. Certain things may happen that are beyond one's control. Nevertheless, if revenue projections cannot be met, then certainly expenses can be controlled.

There is no magic formula, though. Instead, Sidney F. Jarrow, an Elmhurst, Illinois, practitioner, believes in management by objectives and firm commitment. To increase profits, he says, bill aggressively and not defensively. Find new marketing niches and sell present clients additional services they can use. To reduce expenses, he advocates using labor more effectively.

H.W. Martin, a retired practitioner from Rome, Georgia, also doubts that there is a special way to plan for such growth. He says that there are many factors that change a business over a five-year time span, such as the countless mergers that have involved local accounting practices, to make such planning impossible. Long-range planning for nebulous goals is not practical, he says, but such planning is necessary for events that will happen, such as every partner leaving at some time.

What's Inside...

Mr. Martin recommends that CPAs spend more time on short-term planning for today, tomorrow, and next week. Doing a good job with your present time will assure a better future, he says.

What are the critical factors to monitor?

Mr. Jarrow suggests looking at write-downs and write-ups, profits before partners' salaries, gross billings per partner and per employee, then at gross profit per partner and per employee.

Mr. Israeloff says that the key fact or statistic to be monitored regularly is the percentage of chargeable time of staff and partners. This statistic still reflects the "bread and butter" of our profession, namely, the utilization of our people, he adds.

Mr. Israeloff suggests that if staff members get below seventy-five percent chargeable, start looking at their activities and productivity. He says there may be good reason for the lower chargeable time, such as practice development or state society activities, but the percentages must be recorded. If a line partner falls below sixty percent chargeable time, then, he says, the managing partner must investigate.

What percentage should net income and staff salaries be of gross billings?

Mr. Israeloff believes that staff salaries should not exceed thirty-five percent of gross billings. He includes all salaries, professional and administrative, and says that Israeloff, Trattner & Co. aims for thirty percent, and also targets forty percent net income.

Mr. Berenson thinks staff salaries should be approximately thirty-five to thirty-eight percent of revenue, and suggests thirty to thirty-three percent for net income.

Focusing on a percentage of gross billings for net income and staff salaries can be dangerous, though, according to Mr. Serotta. Each firm is different, he

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AICPA CPE Conferences Calendar

1989 Tax Season Survival Conference
January 9-10, 1989—Orlando, FL
January 19-20, 1989—Scottsdale, AZ

2nd Annual Building and Managing a Successful Tax Practice Workshop
April 27-28, 1989—Tempe, AZ

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Level I **May 14-18, 1989**—Charlottesville, VA
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1989 AICPA Annual Microcomputer Conference & Exhibition
June 12-14, 1989—Chicago, IL

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Level II **June 19-23, 1989**—Urbana, IL
Level III **July 10-14, 1989**—Urbana, IL
Level IV **July 17-21, 1989**—Urbana, IL
Level V **July 24-28, 1989**—Urbana, IL

National Accounting & Auditing Advanced Technical Symposium
June 26-27, 1989—Washington, DC
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July 26-28, 1989—San Diego, CA

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Editor: Graham G. Goddard

says. For instance, the number of partners to staff will affect the amount of net income. If a firm takes in a partner before achieving billing criteria, then obviously its net income per partner will be less. This may be done because the firm is young, or because the partners desire to recruit and retain staff by advancing people to partner at a faster pace than other firms.

Mr. Serotta says that staff salaries as a percentage of billings probably run between thirty and thirty-seven percent. This again is affected by the type of practice and the partner/staff ratio. If there are few partners doing productive work, staff salaries may be higher. If, on the other hand, there is a substantial number of productive partners and few staff, the salary percentage would be lower. Also, keep automation in mind, he says. Progressive firms that make full use of the latest computer auditing and tax packages should find that salaries are a smaller percentage of their total billings than firms that are less automated. ☑

Managing Financial Wellness

Many software programs become "shelfware," that is, they sit idly on a shelf because they are too complicated for the average user to understand. So when developing the "Home Financial Organizer," I determined that the product should offer clients an easily learned way to track cash flow, while providing a database for business and personal records.

It occurred to me while developing this product that people who manage successful careers and businesses, frequently don't manage their personal resources and finances as readily. CPAs are no exception to this. It occurred to me, also, that there are similarities between the principles of physical wellness and financial wellness. Just as one's physical wellness requires a commitment to maintaining a balanced diet and a program of regular exercise, so does financial wellness require one to commit time on a regular basis to a review of personal finances and the setting of goals and objectives. Of course, a hard part of any wellness program is getting started. Following, are twelve steps on the road to financial wellness that all can take:

- ☐ **Commitment.** Both spouses or the head of the household must commit to devoting uninterrupted time to a regular review of the family's finances. Commitment requires discipline.
- ☐ **Know how money is spent.** A key element is knowing one's cash flow—how discretionary income is spent, as well as meeting fixed obligations. The goal should be to make conscientious buying decisions.
- ☐ **Know credit card buying habits.** Credit card purchases should be for convenience, not for debt financing. The goal should be to pay credit card purchases on a current basis.
- ☐ **Set financial goals.** Financial goals should be developed for the next six months, one year, three years, and five years.
- ☐ **Compare expenditures to financial goals.** Monitoring total expenditures with established financial goals should be continuous.
- ☐ **Determine assets.** It is important to determine assets accumulated to date and to inventory them.
- ☐ **Determine liabilities.** Summarize liabilities such as bank debt, real estate mortgages, and unpaid credit card purchases. Include contingent liabilities such as bank loan guarantees.
- ☐ **Review insurance policies.** Life, disability, liability umbrella, hospitalization, and automotive insurance requirements should all be reviewed. Coverage should be consistent with financial goals, and insurance on any children considered. Finally, a list of all insurance policies, insurance companies, policy numbers, and insurance agents should be compiled for future reference.
- ☐ **List all professional advisors.** Maintain a listing of names, addresses, and phone numbers for all professional advisors such as attorney, CPA, financial planner, and insurance agent.
- ☐ **Review wills.** Reviewing wills is particularly important because of changes in the tax law, and because of changing circumstances.
- ☐ **Hold a family retreat.** Take advantage of hotel weekend rates to get away from interruptions at home in order to review the steps to financial wellness. The true state of the family's finances should be openly discussed, and the reality of the financial goals assessed.
- ☐ **Hold periodic meetings.** There should be regular meetings between client and financial advisors to review the information accumulated in steps two through ten.

We all tend to procrastinate if something does not seem to be particularly urgent. But each day we delay is simply delaying our families' start in achieving financial wellness. The twelve steps just described can lay the groundwork to improved financial strength and better planning for the future not just for our clients, but also for ourselves. What is required is a commitment to taking the first step. ☑

—by **Charles H. Armstrong, Jr.,** *CPA, Armstrong Financial Organizer, Inc., 5950 Berkshire Lane, L.B. 59, Dallas, Texas 75225-9990, tel. 800-451-2856.*

Survival and Success Strategies (Part 2)

The first part of this article, in the November issue, dealt with the role of strong management and niche marketing, and the need for profitability if firms are to survive and prosper in the years ahead. This part will focus on partners.

Partner compensation

The consultants unanimously counsel firms against having an equal compensation system. They say that one of the reasons some firms don't truly operate as businesses is because they don't adjust compensation to reflect the impact individual partners and staff members have on the long-term growth and profitability of the firm.

Many of the consultants reported that they see a trend away from compensating partners equally, however, and away from compensation systems based on seniority. They say that there is a growing acceptance of performance-based compensation, even by partners who have been in the profession 20 to 30 years.

Separate the issues

There are a series of issues which should be considered separately when determining compensation, but many firms tie them together. Firm ownership is different than voting on the majority of issues that come before the partnership, for example. So are the annual compensation to which the partner is entitled, the partner's capital contribution and the return on it, and how a partner's retirement benefits are structured. These issues should be treated separately.

The client service partner is particularly valuable.

The consultants suggest that a compensation system contain the following three components:

- ☐ Ownership and a return on invested capital.
- ☐ Market value, that is, the annual worth of a particular partner's services. This can be calculated by determining how much the partner's services would be worth to a competitor.
- ☐ Bonuses for extraordinary services performed during the year.

Several of the consultants expressed reservations about the use of bonuses, believing that these are often perceived as something due rather than earned. One alternative suggested is for a discretionary fund to be set up which the managing partner could distribute strictly on current-year performance in excess of standards for that year.

A model partner compensation system

According to the consultants, one well-received compensation system is a multilevel one arranged as follows:

- ☐ **First level.** Return on partners' capital paid at prime rate plus three percentage points.
- ☐ **Second level.** Salary, with consideration given to management responsibilities and contribution to firm profitability.
- ☐ **Third level.** Bonus program based on current-year performance only. Distribution totally at the discretion of the managing partner.
- ☐ **Fourth level.** A portion of the excess profits (deficits) is allocated to partners in proportion to their salaries.
- ☐ **Fifth level.** A portion of the excess profits (deficits) is allocated to partners in proportion to their capital.

The panel agreed that in the typical successful firm, the compensation of the highest-paid partner is at least 2½ times that of the lowest-paid partner, but is usually not more than 4 times as much. One practice encouraged by the consultants is to allow senior managers to invest in the partnership. This gives them some lead time in which to accumulate their capital contribution, should they be offered partnership.

Ways to determine compensation

The consultants discussed the "slip of paper" method of distributing profits (see the August 1988 issue, page 6), and those who had experience with the practice agreed that it works remarkably well. The average of recommendations are usually within acceptable limits, and can either be the basis for the final determination of partners' compensation or a significant tool for the compensation committee or managing partner to use. At larger firms, where all partners' values to the firm are not known, a similar exercise could be effective at the department or office level.

Common characteristics of successful partners

While skill in practice development is important and technical competence is an assumed quality for all partners, the partner skilled in client service is particularly valuable when it comes to client retention. For the most part, clients aren't in a position to accurately assess technical competence. What clients are aware of, though, is when a partner doesn't return their phone calls, or when their financial statements are late. The clients simply don't feel valued.

The group concurred that fees are rarely the primary reason why clients change CPA firms. Often it is really the imbalance between the perception of value received and fees charged. In many instances, clients would actually pay more and ask for more services if only the CPA spent more time developing and nurturing the relationship. ☑

—by **Allan D. Koltin, CPA,** *Practice Development Institute (PDI), 401 North Michigan Avenue, Chicago, Illinois, 60611-4240, tel. (800)227-0498; in Illinois, (312)661-0300*

Editor's note. Mr. Koltin would like to thank the following individuals who participated in the roundtable: August Aquila, Gene Cohen, David Cottle, David Donaldson, Don Faber, Irwin Friedman, Donald Jenkins, Charles Larson, Bob Martin, Jay Nisberg, Michael Schoenecker, Donald Scholl, and Morrey Shifman.

The Accountant as Diagnostician

Would you like to be confident that each time you made a presentation to a prospective client, you control the meeting? You can be in control if you learn to ask the right questions at the right time. The interview process should occupy most of the meeting time, and the prospective client should do most of the talking. More often, though, people spend more time expounding on what they have done for others. This is a mistake. Prospective clients are primarily interested in what you can do for them.

When I conduct training seminars on selling and personal marketing skills for accountants and other professionals, I suggest they draw an analogy to the doctor–patient relationship when considering the interview phase of a presentation. Physicians spend most of their time examining patients and asking questions. They spend little time in writing out prescriptions, and in explaining the cures they have effected. They ask questions because it is necessary for their diagnoses. Equally important, they condition their patients to accept both the diagnosis and the prescription. Therefore, only by asking the right questions can you diagnose the prospective client's specific situation and needs, and effectively present your strengths.

By having both the ability and the willingness to ask questions, you will acquire a wealth of useful data. You will show your interest, draw the buyer out, and develop a working relationship. In addition, if you do it right, you will gain control, credibility, and perceived equality.

- ☐ **Control.** When you ask someone a question, you are in effect dictating who will speak, on what subject, and when. If you are concerned about the length of the response, you can interrupt and ask another question. You could, for example, say, You just said something that triggered a thought, and ask another question. You maintain control.
- ☐ **Credibility.** When you ask incisive, perceptive questions, the other party soon realizes that you know the subject and that you are thorough. You gain credibility. There is no need to tout your abilities.
- ☐ **Perceived equality.** As a professional in your own field of expertise, you have a considerable amount of knowledge, information, and data on which to draw. In most situations, you know more about the topic at hand than the majority of people with whom you are speaking.

You are due equal standing with potential buyers. Give the buyer credit for knowing his or her business, but give yourself credit, also, for knowing yours. What needs to be established is a sense of equality.

The art of asking questions

To clear the way for an effective interview, first ask prospective clients if they mind if you ask questions. Most will probably say, Of course not, go ahead. By getting permission to probe, you won't appear pushy and will most often find that people tell you their needs. Specific answers and insights will follow as long as you maintain an empathetic attitude.

Start the interview with general, open-ended questions that elicit discussion. Don't ask questions that can be answered with only one word. You could for example, use the best/worst method. First, ask a series of questions to find out what the other party likes best about a service or product. Then find out what they don't like about it.

One of the greatest strengths you have going for you is being able to walk away from potential clients if you can't provide a service that meets their needs. This is not only an ethical necessity, but also a marketing asset—one that gives credibility and authority to your presentation.

Being able to walk away is quite different from displaying your services like merchandise in a bazaar. That, in effect, says, Here's what I've got. See anything you need?

The last point is absolutely central to selling your services. The objective of the interview is *not* to sell. It is to find out what the client or potential client needs or wants. If you arrive at that point and respond effectively, you are likely to close the deal. ☑

— by **Mike McCaffrey,** *P.O. Box 4101, Laguna Beach, California 92652, Tel. (714) 497-6616*

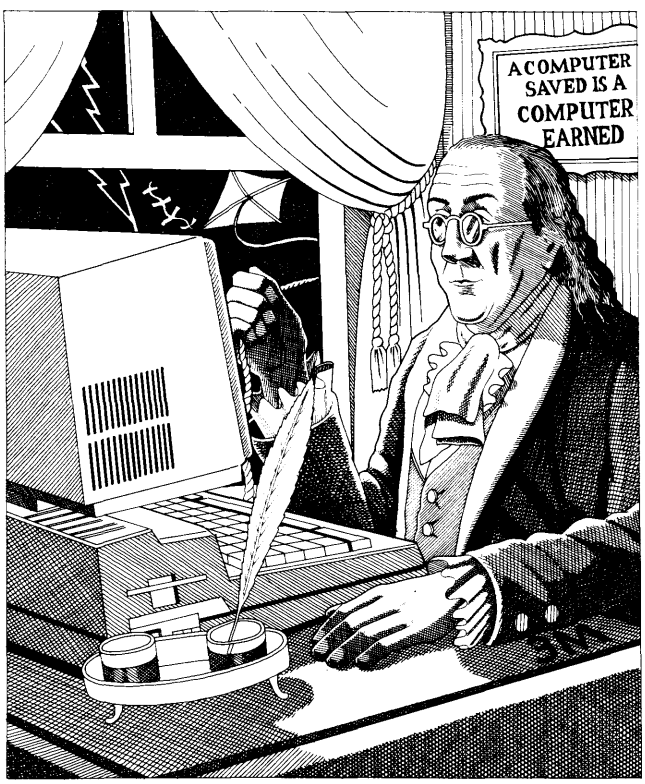
Light Lightning

A flash of lightning or the crash of thunder is a vivid reminder to install surge protectors and suppressors or uninterruptible power supply devices to prevent damage to computer equipment. There is a "light" lightning, however, that while not as spectacular as the bolt in the illustration, may actually cause more damage to electronic circuits.

Many people underestimate the destructive effects of static electricity—the "light" lightning. "Yet," explains Len Meissner, a specialist in the Memory Technology Group Laboratory of 3M Company in St. Paul, Minnesota, "it requires 30,000 volts for a spark to jump one centimeter. And on a really dry day, a spark can jump that far." He says that is why integrated circuits (ICs) are packaged in conductive material for shipping. A static discharge into an IC's leads could destroy the chip. Outside the equipment, these chips are especially vulnerable. Even placing a charged foam coffee cup within two inches of a circuit board could destroy the ICs on it.

Earlier integrated circuits that were less densely packed with circuitry could withstand static charges up to 1,000 volts. New technology has increased the power of ICs, allowing more devices to be installed on one. The increased power has also resulted in a proportionately smaller voltage being able to damage one, however, perhaps as little as 100 volts in an unprotected IC.

Mr. Meissner says that once installed in a computer, more than 100 volts are needed to destroy a chip, but "light" lightning can still damage electrical circuits. Static can also affect magnetic media such as floppy diskettes or large-capacity fixed disks, altering data or irrevocably freezing the operation of a program.



A spark of electricity goes to ground via the path of least resistance. When that path is inside a computer's integrated circuitry, the effect could be compared to eroding a hole in a dike. Every succeeding spark opens the hole a little larger and weakens the dike (the IC) a little more, causing sporadic problems. Finally, the IC breaks, requiring expensive repair and replacement of the affected part. Static buildup may even make dust stick to floppy diskettes, which could lead to data loss or head wear. Mr. Meissner explains, however, that the magnetic coating on diskettes is conductive and this reduces the chance of this happening.

There are a number of methods available to reduce the possible damage caused by "light" lightning. Antistatic sprays can be used on a regular basis, and some specially treated carpets drain static out of the person using the machine.

Some people believe it is better to remove static at the electronic instrument. Static mats are placed on workbenches in manufacturing plants and electronic workshops, so that individuals working on integrated circuits can drain static constantly. Workers may even wear grounded wrist straps for further protection.

In offices, antistatic mats are being installed under electronic typewriters, microcomputers, and other electronic equipment. Designed to extend out on all sides of the equipment for easy, constant contact, the mats are commonly grounded to an electrical outlet via the screw that holds on the outlet's faceplate. A resistor in the grounding cord slowly drains out static when the user touches the mat. This is preferable to discharging it in a short, sharp, and sometimes painful "zap."

Other ideas include grounded static strips such as 3M's "First Touch" static control keyboard strip. Made out of the same materials as a mat, such strips are placed on machines where users can rest their thumbs or palms on them—thus ensuring a constant drain of static.

By the way, where the dust on your computer monitor is concerned, high voltage in the picture tube, rather than static is the villain. In this instance, an antistatic screen cleaner such as "Clean 'N' Safe" should reduce the attraction to dust and help improve visibility. ☑

—by **Dale Archibald,** *P.O. Box 6573, Minneapolis, Minnesota 55406, tel. (612) 724-8917*

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